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No. 99-31

IN THE
Supreme Court of the United States

W.R. GRACE & CO.-CONN. and
CHRYSLER MOTORS CORPORATION,
Petitioners,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Washington

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

PREFACE

In addition to responding to the Petitioners' arguments, the Washington Department of Revenue has raised two new issues. The Petitioners will first reply to these issues and then rebut the Department's responses to the reasons why the Petition for Writ of Certiorari should be granted.

I. ISSUES RAISED BY THE DEPARTMENT

A. The Decision of the Washington Supreme Court Is a Final Judgment That This Court Has Jurisdiction to Review

The trial court entered judgment against Grace in the amount of $1,311,535.00. [No. 99-223 Cross-Pet. App. 4a] The trial court entered judgment against Chrysler in the amount of $1,490,456.00. [Pet. App. 68a] The Supreme Court of Washington affirmed those judgments. *W.R. Grace & Co.-Conn. v. State of Washington, Department of Revenue,* 973 P.2d 1011, 1022 (Wash. 1999). Certainly the parties (including the Department) and the state courts all treated these judgments as "final." Yet, incredibly, the Department now says that there is no final judgment.

The Department premises its position on the fact that the Washington Supreme Court did not pass on the issues of standing and issue preclusion but preserved the Department's right to raise them in the trial court, if necessary. [Resp. Br. in Opp. at 11.][1] However, when the Washington Supreme Court upheld the constitutionality of the MATC as curing the defective B&O tax for periods prior to *Tyler Pipe Industries, Inc. v. Washington Department*

[1] The Department admits that the trial court already denied its motion for partial summary judgment based on issue preclusion. [Resp. Br. in Opp. at 8.] One wonders what possible new grounds for issue preclusion the Department could raise on remand.

of Revenue, 483 U.S. 232 (1987), there was no need for it to pass on any other issues raised by the Department because it had affirmed the judgments against the Petitioners. Of course, if this Court reverses the Washington Supreme Court on federal constitutional issues, the case would then be remanded to the trial court for determination of whether Petitioners can be denied relief because of standing or issue preclusion.

This possibility presents no bar to the jurisdiction of this Court. As explained in *Wright, Miller and Cooper, Federal Practice and Procedure*, Jurisdiction 2d § 4021:

> The Court often makes it clear that once it has decided the federal question, the state issues remain available to support a result that is inconsistent with the Court's resolution of the federal question, and that thus moots its determination.

See, e.g., McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 496 U.S. 18, 25 n.4 (1990) (State may, on remand, deny constitutionally mandated relief based on independent state law grounds requiring prepayment protest of taxes). For example, in *James B. Beam Distilling Co. v. Georgia*, 437 S.E. 2d 782, 786 (Ga. 1993), on remand from this Court in *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529 (1991), the taxpayer was denied relief because the state court found the taxpayer did not bear the economic burden of the taxes for which a refund was sought.

The Department surely cannot assert that the Washington Supreme Court's decision rests upon independent state law grounds, because that court declined to rule on standing or issue preclusion. *Grace*, 973 P.2d at 1016. As this Court stated in *Caldwell v. Mississippi*, 472 U.S. 320 (1985):

> The mere existence of a basis for a state procedural bar does not deprive this Court of jurisdiction; the

> state court must actually have relied on the procedural bar as an independent basis for its disposition of the case.

Id. at 327. While the Washington Supreme Court remanded this case for further action consistent with its opinion, there would be nothing further for the trial court to do other than perhaps recompute the interest on the judgments and to see to their execution. As explained in 2 *Federal Procedure*, Lawyers Ed. 2d § 3:55,

> If a determination of a federal issue would be conclusive on the outcome of anticipated future state proceedings, the judgment is final for the purpose of Supreme Court review. This situation may arise when the party seeking review has no other claims or defenses to raise other than the federal claims which have been conclusively decided. . . .

If the Petitioners cannot get the decision of the Washington Supreme Court reversed, they are out of luck because the case will be over. For this reason, this case falls squarely within the finality doctrine of *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 479 (1975),[2] upon which the Department relies.

This is the only time Petitioners will have an opportunity to seek review of the decision below that the retroactive assessment of the unconstitutional B&O tax does not violate the United States Constitution. For the purposes of this Court's jurisdiction, this represents finality under any plausible standard.

B. *Tyler Pipe* Was Properly Given Retroactive Application

The Department's passing argument that the Court's decision in *Tyler Pipe Industries, Inc. v. Washington De-*

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[2] This Court noted in *Cox* its previous holding that "the requirement of finality is to be given a 'practical rather than a technical construction.'" 420 U.S. at 479 n.7 (quoting *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949)).

partment of Revenue, 483 U.S. 232 (1987), should not have been given retroactive application, is patently refuted by this Court's decisions in *James B. Beam Distilling Co. v. Georgia,* 501 U.S. 529 (1991), and *Harper v. Virginia Department of Taxation,* 509 U.S. 86 (1993). Because the Department refers to its conditional cross-petition, Supreme Court No. 99-223, for its argument on this issue [Resp. Br. in Opp. at 13], Petitioners will respond to these arguments in their brief in opposition to the conditional cross-petition.

II. REASONS FOR GRANTING THE WRIT

A. The MATC Does Not Provide Taxpayers With a "Clear and Certain Remedy" for the Unconstitutional B&O Tax Because It Imposes Onerous, Discriminatory and Retroactive Record-Keeping Requirements and Provides No Meaningful Backward-Looking Relief

The Department erroneously relies on this Court's dicta in *Tyler Pipe* that "an expansion of the multiple activities exemption to provide out-of-state manufacturers with a credit for manufacturing taxes paid to another State would presumably cure the discrimination." 483 U.S. at 249. [Resp. Br. in Opp. at 4.] At most, the Court was suggesting that a properly drawn statute authorizing a credit for out-of-state manufacturing taxes might eliminate future discrimination. The Court was not referring to the clear and certain remedy to which the petitioners were entitled when faced with a retroactive assessment predicated upon an invalid statute.[3]

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[3] The *Tyler Pipe* Court obviously did not have the MATC statute and regulations before it, nor could the Court have envisioned the onerous requirements for interstate businesses to qualify for the MATC and the discriminatory effect it engenders. In the complete vacuum of *Tyler Pipe*, the Court's theory was correct. That theory has not been implemented by the MATC. Similarly, the Department's effort to find support in *General Motors Corp. v. City and County of San Francisco*, 69 Cal. App. 4th 448, 81 Cal. Rptr. 2d

The Department fails to appreciate the significance of *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990). In *McKesson*, this Court held that when a state's taxing statute is declared unconstitutional as being in violation of the Commerce Clause, the state must provide a "clear and certain" remedy for the aggrieved taxpayer. The Court spelled out the nature of the remedy by explaining that the state must either (1) refund the taxes, (2) assess and collect equivalent back taxes from the taxpayer's competitors, or (3) accomplish a combination of the two. 496 U.S. at 40-41.

The fact that the taxpayer in *McKesson* was seeking a refund while Petitioners are seeking to enjoin a retroactive assessment does not diminish the controlling authority of *McKesson*. The Court's holding was that the unlawful tax discrimination must be eliminated in some fashion that equates the economic burden imposed on the benefited and aggrieved taxpayers. The State of Washington has not chosen to tax Petitioners' in-state competitors in order to eliminate the discrimination. Therefore, the clear and certain remedy for Petitioners is an injunction against the retroactive assessment.

Moreover, Petitioners do *not* concede that the MATC is a "clear and certain remedy under *McKesson* if it merely, in hindsight, creates a non-discriminatory tax scheme." [Resp. Br. in Opp. at 14.] The MATC was retroactively imposed upon Petitioners as the exclusive remedy for the unconstitutional B&O tax in lieu of existing remedies (a "bait and switch" discussed under point B below), and contains onerous and discriminatory recordkeeping requirements in order for interstate businesses to qualify for any

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544 (1999) [Resp. Br. in Opp. at 14 n.3], is unavailing. That court did no more than suggest—as this Court did in *Tyler Pipe*—that, in theory, an appropriate tax credit equally available to intrastate and interstate businesses should eliminate impermissible discrimination.

credit. Thus, the MATC is neither a "clear" nor a "certain" remedy to Petitioners.

The Department attempts to ameliorate the virtually impossible burden of complying with the MATC by filing affidavits and suggesting that it does not enforce the letter of the law. [Resp. Br. in Opp. at 15 & 18a-26a.] Affidavits are not the law. Whatever ad hoc administration the Department may employ cannot cure the constitutional defects in the MATC. If anything, these affidavits show that the Department, too, recognizes that the MATC is burdensome and onerous.

The Department tries to minimize the discriminatory effect of the MATC, arguing that it merely "ensures that interstate and local businesses will bear the same tax burden" [Resp. Br. in Opp. at 2], by "completely eliminating" taxpayers' exposure to multiple taxation. [Resp. Br. in Opp. at 14.] The law, itself, shows otherwise. While intrastate taxpayers may automatically credit extracting and/or manufacturing B&O taxes paid against selling B&O taxes due, W.A.C. 458-20-19301(3)(e) [Resp. Br. in Opp. 8a], an interstate taxpayer must prove not only the "similarity" between another jurisdiction's gross receipts tax on extracting and/or manufacturing, WAC 458-20-19301(2)(c) and (d)(ii) [Resp. Br. in Opp 6a], and (5) [Resp. Br. in Opp. 10a-11a],[4] but also must maintain extensive records to prove:

> The business activity subject to tax, and against which credit(s) is claimed, must involve the same ingredients or product upon which the tax giving rise to the credit(s) was paid. The credits must be product-specific.

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[4] The MATC does not apply to every garden variety gross receipts tax, as the Department contends. [Resp. Br. in Opp. at 17.] The Department's regulations narrow the scope of gross receipts taxes that will qualify for the credit and impose the burden on the interstate taxpayer to prove that qualification. WAC 458-20-19301(5)(a)-(c), [Resp. Br. in Opp. 10a-11a.]

WAC 458-20-19301(4)(d) [Resp. Br. in Opp. 9a.][5] These records are anything but "normal" documents.

B. Washington's Refusal to Grant Injunctive Relief or Refunds Under Existing Statutes, Its Retroactive Imposition of the MATC as the Exclusive Remedy, and Its Assessment of Additional Deficiencies, Are Unconstitutional "Bait and Switch" Tactics Under the Due Process Clause

Despite its rhetoric, the Department has presented no justification for the bait-and-switch tactic employed by the State of Washington. In *Reich v. Collins,* 513 U.S. 106 (1994), and *Newsweek Inc. v. Department of Revenue,* 522 U.S. 442 (1998), the bait was holding out one remedy to taxpayers and later, after the tax was challenged, the switch was the substitution of a different, exclusive remedy. Here, the State of Washington's bait was a statute authorizing an injunction against the assessment of an unconstitutional tax. Once the B&O tax was declared unconstitutional, the state switched the taxpayers' exclusive remedy to a credit which required the production of records they had no reason to keep in the first place.

The issue is not, as the Department contends, whether Petitioners had a right of action to challenge the Department's assessments. [Resp. Br. in Opp. at 19.] The issue is the relief to which Petitioners are entitled from B&O taxes this Court held were unconstitutionally discriminatory in *Tyler Pipe.* As discussed at length in these taxpayers' petition, the MATC simply does not afford any meaningful backward-looking relief from the unconstitutional B&O tax.

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[5] The Department's regulations further provide that "Other states' tax payments claimed for MATC must be identifiable with the same ingredients or products which incurred tax liability in Washington State, *i.e.*, they must be product-specific." WAC 458-20-1930(5)(c) [Resp. Br. in Opp. 11a.]

The Washington Supreme Court, itself, held that if *Tyler Pipe* were retroactive, the taxpayers were entitled to refunds. *National Can Corp. v. State Department of Revenue*, 749 P.2d 1286 (Wash.), *cert denied*, 486 U.S. 1040 (1988). Yet, when faced with the realization that *Tyler Pipe* was retroactive, the Supreme Court of Washington has sanctioned the switch by upholding the retroactive application of the after-the-fact MATC. This Court should put an end to such bait-and-switch tactics.

C. Washington's Retroactive Assessment of an Unconstitutional Tax for Tax Periods Up to Seven Years Prior to the Declaration of Unconstitutionality Violates the Due Process Clause

The Department belittles the Petitioner's complaint that a retroactive tax assessment of an unconstitutional tax for a period of up to seven years violates due process. [Resp. Br. in Opp., p.21-23] Yet, the Department can point to no case that has upheld a retroactive assessment of that duraction. The Department suggests that Petitioners cannot complain because the 1987 statute authorizing the MATC did not increase their tax burden. Of course the 1987 statute did not increase the tax burden. Petitioners' tax burden was imposed by the original B&O tax, which was declared unconstitutional in *Tyler Pipe*. The 1987 statute was an effort to salvage this unconstitutional tax by offering the possibility of an illusory tax credit.[6]

The due process issue before the Court is whether the unconstitutional B&O tax and the requirements of the MATC can be applied to the Petitioners retroactively. In 1994, even the Washington Legislature recognized the

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[6] The Department's candid quotation from *American Nat'l Can* [Resp. Br. in Opp. at 22], and statement of legislative intent behind the MATC [Resp. Br. in Opp. 1a], point up the real purpose of the MATC: to appear to resolve the unconstitutionality declared in *Tyler Pipe* while maximizing the state's revenues. This aim has come at the expense of interstate taxpayers such as Petitioners.

unfairness of a retroactive application of the MATC by expressly limiting its application to "all tax reporting periods [ending] on or after June 23, 1987," the date of *Tyler Pipe*. Laws of 1994, ch 124 § 7. Yet, inexplicably, the Washington Supreme Court has now held that the MATC can be retroactively applied for a period up to seven years prior to *Tyler Pipe*. The due process violation can hardly be clearer.

D. Washington's Failure to Apportion the B&O Tax to Reflect the Location of Taxable Activities Violates the Commerce Clause

The Department's response to Petitioners' apportionment argument essentially consists of stating that this Court has already decided the issue. Petitioners do not dispute that in *Tyler Pipe* this Court held that the B&O tax was fairly apportioned because it was analogous to a sales tax. Petitioners' point is that subsequent to *Tyler Pipe*, the Court in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995) abandoned the rationale of analogizing a gross receipts tax to a state tax for purposes of apportionment. Thus, there is no issue preclusion in this case.

In upholding the sales tax at issue in *Jefferson Lines*, the Court found it necessary to distinguish its earlier decision in *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948), which required apportionment of a gross receipts tax on interstate activity. The Court explained that the gross receipts tax in *Central Greyhound* was "simply a variety of tax on income, which was required to be apportioned to reflect the location of the various activities by which it was earned." *Jefferson Lines*, 514 U.S. at 190. Thus, it is evident that the Court has since *Tyler Pipe* come to the view that a gross receipts tax on interstate transactions must be apportioned to reflect a tax on only that part of the total activity occurring within the state. Moreover, the possibility of a credit against a gross re-

ceipts tax (such as through the MATC) cannot cure an unconstitutional failure to apportion the tax. *Central Greyhound Lines,* 334 U.S. at 663. Washington cannot, consistent with *Jefferson Lines* and *Central Greyhound,* tax more than its fair share of interstate activity simply by enacting a tax different from most other states' taxes and then refusing to grant any credit based on those differences and refusing to apportion its tax.

As pointed out by Professors Hellerstein, McIntyre and Pomp, *Commerce Clause Restraints on State Taxation After Jefferson Lines,* 51 Tax L. Rev. 47:

> Regardless of how subsequent cases may view *Jefferson Lines*' implications for gross receipts taxes, the wisdom of requiring apportionment in many situations can be demonstrated by revisiting *Tyler Pipe.*

Washington vainly attempts to argue that its B&O tax is "inherently apportioned" because it taxes only extracting, manufacturing, and selling activities that occur in Washington. [Resp. Br. in Opp. at 23-24.] That argument fails under the selling tax challenged by Petitioners in this case. The Washington B&O tax is absolutely *unapportioned* because it taxes the full gross receipts of selling activity—receipts that include moneys attributable to extracting, manufacturing, and distributing activities that occur in other states. This situation is no different than if Washington tried to tax the entire, unapportioned net income of a multistate business—the State is attempting to tax values earned outside its borders.

CONCLUSION

For thirteen years, the State of Washington has done everything in its power to thwart the Court's holding in *Tyler Pipe.* Petitioners urge the Court to grant the Writ of Certiorari, void the assessments, and order the Washington Supreme Court to enter judgments for the Petitioners.

Respectfully submitted,

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